

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

APPLICATION OF FRIENDLY )  
UTILITIES, INC., D/B/A FRIENDLY )  
HILLS E. SEWER SYSTEM FOR A RATE ) CASE NO. 9129  
ADJUSTMENT PURSUANT TO THE )  
ALTERNATIVE RATE FILING PROCEDURE) )  
FOR SMALL UTILITIES )

O R D E R

On September 7, 1984, Friendly Utilities, Inc., d/b/a Friendly Hills E. Sewer System ("Friendly") filed an application with the Commission to increase its sewer rates pursuant to 807 KAR 5:076. This regulation allows utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative rate filing method in order to minimize the necessity for formal hearings, to reduce filing requirements and to shorten the time between the application and the Commission's final Order. This procedure should minimize rate case expenses to the utility and, therefore, should result in lower rates to the ratepayers.

There were no intervenors in this matter, and all information requested by the Commission has been submitted.

Friendly requested rates which would produce an annual increase of \$28,782 to its present gross revenues. In this Order, the Commission has allowed rates to produce an increase of \$23,235.

### TEST PERIOD

For the purpose of determining the reasonableness of the proposed rates, the 12-month period ending December 31, 1983, has been accepted as the test period.

### REVENUES AND EXPENSES

Friendly showed a net loss on its books for the test period of \$15,449. Friendly proposed several pro forma adjustments to its test period operating revenues and expenses to more accurately reflect current operating conditions. The Commission finds these adjustments reasonable and has accepted them for rate-making purposes with the following exceptions:

#### Water Expense

During the test period, Friendly incurred water expense of \$1,473. The Louisville Water Company ("LWC") announced in the month of December 1984 that rates for water service would be increased by 7.2 percent effective January 1, 1985. Therefore, the Commission found it appropriate to make a pro forma adjustment to water expense of \$106.<sup>1</sup>

#### Purchased Power Expense

Friendly projected a pro forma adjustment of \$988 to actual purchased power expense of \$13,170 for the test period. The Commission finds it appropriate to decrease this adjustment by \$125, which, in total, represents the 6.55 percent increase granted the Louisville Gas and Electric Company in its last rate case before the Commission (Case No. 8924), granted

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<sup>1</sup> \$1,473 X 7.2% = \$106.

subsequent to the test period in this case. Therefore, the Commission has included adjusted purchased power expense of \$14,033<sup>2</sup> in test year expenses.

Maintenance of Treatment and Disposal Plant

During the test period, Friendly booked \$5,627 in the maintenance of its treatment and disposal system. An analysis of the individual invoices showed that during the test period Friendly made the following plant additions but erroneously expensed these items:

<u>Date</u>	<u>Invoice Number</u>	<u>Vendor</u>	<u>Item</u>	<u>Amount</u>
3/28/83	328-2	Andriot-Davidson Company	Motor for variable speed pump	\$ 819
4/09/83	409-28	Andriot-Davidson Service Company	Installation cost for variable speed pump	299
4/09/83	409-10	Andriot-Davidson Service Company	Replace valves in compressor	318
3/28/83	328-10	Andriot-Davidson Service Company	Replace gaskets in compressor	221
5/09/83	509-4	Andriot-Davidson Company	5 H.P. motor for sludge air lift blower	164
3/04/83	304-40	Andriot-Davidson Service Company	Major repair-pump	513
10/25/83	1025-16	Andriot-Davidson Service Company	Major repair-digest-or blower motor	347
10/25/83	1025-16	Andriot-Davidson Service Company	Major repair - #2 sewage pump	476
Total				<u>\$3,157</u>

<sup>2</sup>  $\$13,170 \times 6.55\% = \$863 + \$13,170 = \$14,033$

The above listed items will be given proper consideration by the Commission with regard to allowable depreciation expense. Therefore, test period expenses related to the maintenance of the treatment and disposal system have been reduced by \$3,157.

#### Collection Expense

The collection expense is directly related to the amount of revenue that Friendly collects via the formula used by the LWC to calculate the collection charge.<sup>3</sup> Therefore, the Commission has modified this calculation to include the increased rate allowed herein. The Commission is also using the most recent collection fee charged by the LWC effective May 1, 1984, which results in an annual collection expense of \$2,016.

#### Transportation Expense

Friendly's test period operation and maintenance expenses include transportation charges in the amount of \$982. However, in a response to this Commission's request for information received on November 26, 1984, Friendly stated in item number 2 of the response that it has reduced its pro-rata projection for transportation expense to \$366. There was no documentation provided by Friendly related to its adjusted transportation expense of \$366. The burden of proof is on Friendly to establish justification for this expense. Moreover, reasonable expenses have been allowed in this case for outside service companies to

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<sup>3</sup>  $\$1.80 \times \frac{\text{Sewer Charge}}{\text{Water Charge} + \text{Sewer Charge}} \times \text{No. of customers} \times 6.$

maintain the plant on a routine and non-routine basis. Substantially all transportation to and from Friendly for routine maintenance, sludge hauling and non-routine maintenance is provided for either within a monthly fee or billed by vendors on a per-mile basis.

It is the Commission's policy to allow managers of sewer utilities the size of Friendly annual compensation of \$1,800, including ordinary travel. Additional compensation for an item, such as unusual travel expenses, must be sufficiently documented and justified. It is the Commission's finding that Friendly has not met its burden of proof on this issue and the Commission has, therefore, eliminated recorded test-year transportation expense of \$982 from operating expenses for rate-making purposes.

#### Routine Maintenance Expense

Friendly incurred \$6,600 for routine maintenance expense for the test period. This fee has been constant since Friendly was transferred from Future Federal Savings and Loan Association in 1982. Although no adjustment has been made in this Order for a routine maintenance fee, it should be noted that the Commission does not find the test period amount of \$6,600 to be a reasonable expense (i.e., reductions could be necessary). This amount will be a point of reference in future cases. Further, the Commission will not allow further cost increases in transactions with affiliated companies without persuasive justification.

#### Depreciation Expense

At the end of the test period, Friendly had recorded depreciation expense of \$11,140. The Commission, in its

disallowance of capital items of \$3,157 included in the cost of maintaining the treatment and disposal plant as discussed above, has allowed a pro forma depreciation expense adjustment of \$1,052 computed on the basis of a 3-year service life of the property which is properly transferred to Account No. 373, Treatment and Disposal Equipment. Therefore, the Commission's reasonable adjusted depreciation expense for the test period is \$12,192.<sup>4</sup>

#### Income Taxes

Friendly projected pro forma federal and state corporate income taxes, and the Jefferson County 2.2 percent Occupational Tax totalling \$2,622 for the test period. The Commission is of the opinion that the federal and state corporate income taxes, and the Jefferson County 2.2 percent Occupational Tax should be allowed for rate-making purposes and the computation will be made in a later section of this Order.

Therefore, Friendly's adjusted operations at the end of the test period are as follows:

	<u>Friendly Adjusted</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 46,120	\$	\$ 46,120
Operating Expenses	<u>55,153</u>	<u>(5,278)</u>	<u>49,875</u>
Net Operating Income	<u>(9,033)</u>	<u>5,278</u>	<u>\$ (3,755)</u>
Interest Expense	<u>10,761</u>		<u>10,761</u>
Net Income	<u><u>\$ (19,794)</u></u>	<u><u>\$ 5,278</u></u>	<u><u>\$ (14,516)</u></u>

<sup>4</sup> Depreciation Expense, per books, at 12/31/83	\$11,140
Add: Depreciation expense on capital items transferred from maintenance of treatment plant - \$3,157 X 33.33 percent =	<u>1,052</u>
Total allowable depreciation expense	<u><u>\$12,192</u></u>

### REVENUE REQUIREMENTS

The Commission is of the opinion that Friendly's adjusted operating loss is unfair, unjust and unreasonable. The Commission is further of the opinion that an operating ratio of 88 percent is fair, just and reasonable in that it will allow Friendly to meet its operating expenses, service its debt and provide a reasonable return to its stockholders. Therefore, the Commission finds that Friendly should be permitted to increase its rates to produce an increase in annual revenue of \$23,235,<sup>5</sup> which includes federal, state and Jefferson County income taxes of \$1,687.

### SUMMARY

On January 15, 1985, Friendly submitted notice to the Commission of its intent to begin charging the rates advertised in its original application as of February 15, 1985. In a letter of the Commission dated February 11, 1985, the effective date was recognized to be February 27, 1985. In its Order of February 22, 1985, the Commission ordered Friendly to maintain its records in such manner as would enable it, or the Commission, or any of its customers, to determine the amounts to be refunded and to whom due in the event a refund is ordered upon final determination of this case in accordance with 807 KAR 5:076, Section 8.

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

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<sup>5</sup>  $(\$49,876 + \$1,687) \div 88\% = \$58,594 + \$10,761 - \$46,120 = \$23,235.$

1. The rates proposed by Friendly would produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

2. The rates in Appendix A are the fair, just and reasonable rates to charge for sewage services rendered to Friendly's customers and should produce annual revenues of approximately \$69,355.

3. The rates charged by Friendly on and after February 27, 1985, are in excess of the rates approved herein, and therefore, the difference should be refunded to the appropriate customers.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are the fair, just and reasonable rates of Friendly for sewage services rendered on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Friendly be and they hereby are denied.

IT IS FURTHER ORDERED that the revenues collected by Friendly subsequent to February 27, 1985, through rates in excess of those found reasonable herein shall be refunded in the first billing after the date of this Order.

IT IS FURTHER ORDERED that Friendly shall file a statement within 30 days of the date of this Order reflecting the number of customers billed, the amount collected under the rates put into effect on February 27, 1985, the number of customers receiving a refund, the amount refunded and the date of the refund.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Friendly shall file with this Commission its tariff sheets setting forth the rates approved herein and a copy of its rules and regulations for providing sewer services.

Done at Frankfort, Kentucky, this 22nd day of March, 1985.

PUBLIC SERVICE COMMISSION

Richard D. Hemmick  
Chairman

Robert T. Bynum  
Vice Chairman

For Shull  
Commissioner

ATTEST:

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Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE  
COMMISSION IN CASE NO. 9129 DATED 3/22/85

The following rates are prescribed for customers receiving sewer service from Friendly Hills E. Sewer System. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

<u>Customer Class</u>	<u>Rate</u>
Residential	\$23.40
Multi Family	17.55
*Commercial & All Other	43.88 (Per Residential Equivalent)

\*Residential Equivalent = 12,000 Gallons/Month based upon average monthly consumption.